

IRS/EITC Software Developers Working Group

FY 2009 Annual Report

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Table of Contents

Table of Contents.....	i
1. Introduction	1
1.1. Purpose of Report	1
1.2. Key Stakeholders	1
1.3. Voluntary Implementation of Recommendations.....	1
2. Software Enhancement Recommendations in Tax Year 2008	2
2.1. Reliance on Software and Due Diligence Requirements	2
2.2. Tax Year 2008 Software Enhancements.....	2
3. Current Working Group Activities.....	3
3.1. Income Reporting and Schedule C Issues	3
3.2. Schedule C Preliminary Recommendations.....	3
4. Future Working Group Initiatives.....	5
4.1. Next Steps for the Schedule C Recommendations	5
4.2. Form 8867, <i>Paid Preparer's EIC Checklist</i>	5
4.3. Expanding Working Group Efforts to ARRA & Tax Return Preparer Review	5

1. Introduction

The IRS/EITC Software Developers Working Group is a partnership between the IRS Earned Income Tax Credit (EITC) Office and various software industry representatives from within the membership of the National Association of Computerized Tax Processors (NACTP) and the Council of Electronic Revenue Communication Advancement (CERCA). Since this Working Group was formed in February 2008, working sessions have been held to identify issues, potential short-term and long-term best practices, and software enhancements that could improve the quality of EITC returns, increase EITC participation for eligible taxpayers and help preparers meet their due diligence requirements.

For Tax Year (TY) 2008, the Working Group developed and facilitated the communication and implementation of a number of software enhancements designed to improve a preparer's ability to meet his due diligence in accordance with the latest regulations. Recognizing 9 out of 10 taxpayers use a return preparer or tax preparation software, the Working Group, as an influence on the tax software industry, plays a key role in improving the process and accuracy of the tax filing experience. Continuing their work in TY 2009, the Working Group is proposing recommendations focused on issues surrounding the Schedule C, *Profit or Loss from Business*.

1.1. Purpose of Report

The purpose of this document is to acknowledge the TY 2008 software enhancements implemented to address due diligence issues and challenges faced by the EITC program, as well as to address the current and future initiatives identified by the Working Group during their November 2008, and June and August 2009 meetings. The current initiative is focused on identifying software enhancements and additional guidance for preparers who file returns with a Schedule C. Future initiatives will revolve around expanding Working Group efforts on the American Recovery and Reinvestment Tax Act (ARRA) credits and the Tax Return Preparer Review recommendations.

1.2. Key Stakeholders

Although the primary audience of the Working Group recommendations is the tax software industry, this annual report will be shared with return preparers and the IRS community. Members of the Working Group are expected to socialize the information from the Working Group meetings to others within their companies and industry and provide feedback to the group. In order to obtain more information or provide feedback, contact Peter Maser (Peter.E.Maser@irs.gov) or a member of the Working Group.

1.3. Voluntary Implementation of Recommendations

The recommendations of the Working Group will be communicated to the software developer industry with the expectation that software companies will implement some or all of the recommendations. The implementation of these recommendations is voluntary and should not be interpreted as regulatory. In addition, the contents of this report do not constitute official IRS guidance.

2. Software Enhancement Recommendations in Tax Year 2008

2.1. Reliance on Software and Due Diligence Requirements

Feedback from the EITC tax preparer community indicates that preparers rely heavily on their tax software to prepare accurate tax returns and to meet their EITC due diligence requirements. Although tax software cannot act as a substitute for tax preparers' knowledge and professional responsibility, software enhancements may assist preparers in preparing accurate returns and meeting their EITC due diligence requirements. In addition, new EITC Due Diligence regulations were published in TY 2008 which provided clarification of the "Knowledge" requirement of IRC Sec. 6695(g).

2.2 Tax Year 2008 Software Enhancements

The Working Group identified eight short-term recommendations that would have wide applicability to many EITC issues. Based on a July 2008 survey, all but one of the enhancement recommendations were well-received with plans to be voluntarily implemented. Two-thirds of the survey respondents had implemented the first seven enhancements in time for the TY 2008 filing season. Four survey respondents did not intend on implementing the last recommendation to incorporate training materials because their tax software package already has built-in screens or links that point the tax return preparer directly to information located on the IRS website. In summary, preparer feedback was very positive to the software enhancements that were implemented.

The table below lists each of the recommended software enhancements for TY 2008.

#	TY 2008 Recommended Software Enhancement
1	Eliminate the use of default answers where answers are critical to return accuracy.
2	Include pop-ups or additional diagnostics with suggested additional inquiries the preparer may make to assist the preparer to comply with EITC due diligence requirements and identify questionable EITC situations.
3	Utilize diagnostics or training/job aids in order to facilitate the gathering of information from the taxpayer on sensitive questions and additional information.
4	Incorporate a "note" capability in the software where the preparer can record any additional inquiries made and the taxpayer responses.
5	Promote thorough interviews through additional software questions, job aids, training materials and help screens.
6	Add a reminder to preparers that they cannot rely on the software alone to meet their due diligence requirements. The preparer must have a complete understanding of the tax law.
7	Incorporate links in the software to IRS EITC training and resource materials.
8	Incorporate EITC training materials in the software.

Additional feedback about the software enhancements gathered at the 2009 IRS National Tax Forums will be summarized and communicated in media including the Tax Preparer Toolkit located on EITC Central.

3. Current Working Group Activities

3.1 Income Reporting and Schedule C Issues

At the Software Developers Working Group Meeting held on June 10, 2009 in Washington DC, one of the topics of discussion focused on additional training and guidance for tax preparers filing a Schedule C form. Income-reporting errors are among the three most common EITC errors. A subsequent working session was held on August 11, 2009 to specifically discuss problematic areas associated with preparers filing a Schedule C.

Taxpayers filing a Schedule C must report the correct gross income and all related deductions on their return. Determining the correct income and deductions creates an issue for preparers who need to verify the income reported and expenses claimed, whether this is a result of poor record keeping or a direct attempt to falsify figures to optimize credits. The Working Group identified the following common income-reporting issues:

- Questionable Schedule C income to qualify for EITC (i.e., taxpayers with no 1099)
- Questionable Schedule C losses that reduce other income and qualify taxpayers for EITC
- Schedule C income, but the taxpayers have no records for income or expenses
- Income from Schedule C businesses, but no expenses when it is reasonable to expect the taxpayer incurred expenses

3.2 Schedule C Preliminary Recommendations

The Working Group reviewed the common issues and identified preliminary recommendations to address them and provide additional support and guidance to the EITC preparer community. The following proposed recommendations include form changes, software enhancements, and new training material and will be developed in greater detail in follow up working sessions.

- **Add a “1099 Present” indicator to the Schedule C.** To improve the validation and recording of 1099 form data, Working Group members suggested the addition of a checkbox to the Schedule C Form and subsequently to the software programs.
- **Include an alert message for common issues.** To alert preparers to common questionable scenarios, companies are encouraged to insert pop-up messages within their software. Common questionable scenarios include Schedule C without expenses, Schedule C income or loss that maximizes EITC, Schedule C without a 1099, or expenses that are reported that are disproportionate to income. The pop-up should be built in at the end of the return before both parties agree to the completion of the return. The alert should also reiterate the due diligence “knowledge” requirement and prompt the tax preparer to ask the additional questions required to ensure that taxpayers are accurately reporting all income and related expenses when filing the return.
- **Develop training materials regarding Schedule C.** A preparer is often faced with the challenge of determining whether the taxpayer is engaged in a legitimate business. The presence or lack of a 1099 is not the only measure of this. Probing and examining the taxpayer about common issues related to running a business is required to make this

determination. Form 11652, *Questionnaire and Supporting Documentation, Form 1040 Schedule C (Profit or Loss from Business)*, which is used by IRS in Schedule C EITC examinations, could be used to develop/enhance training materials related to Schedule C. Form 11652 and the training materials should be posted to the EITC Preparer Toolkit website. Software developers could then add links within their program to direct preparers to this information.

- **Develop a training document to address the issue of assisting taxpayers with reconstructing income and expenses.** Taxpayers who claim income from self-employment without a Form 1099 should be asked if they have records to support the numbers they provide the preparer. The same is true of Schedule C expenses. To support preparers facing this issue, the EITC Office will lead the effort to create a training document, leveraging existing training material provided by members of the Working Group.

4. Future Working Group Initiatives

4.1. Next Steps for the Schedule C Recommendations

The Working Group is scheduled to meet again in September 2009 to refine each of the Schedule C recommendations proposed for TY 2009.

4.2. Form 8867, *Paid Preparer's EIC Checklist*

Completion of Form 8867, *Paid Preparer's EIC Checklist* is an integral step in the EITC Due Diligence process. The form is currently being revised to reflect new legislative changes to the Uniform Definition of a Child (UDOC) and when the tie-breaker rules apply. The two new additions to the definition of a qualifying child are 1) the claimant must be older than the qualifying child unless the child is disabled and 2) the qualifying child must not have filed a joint return, unless the return was filed to receive a refund only and the couple did not have a filing requirement. In addition, if someone other than a parent claims the child, that person must have a higher AGI than any of the child's parents.

During the June 2009 meeting, the Working Group discussed proposed revisions to the form and a recommendation to submit the form during return transmittal. This recommendation will be explored in later working sessions. Many software developers use an equivalent to the Form 8867 and require the taxpayers to sign it. Although the exact form may not be used, it is important because many taxpayer clients receive a copy for their records and preparers are required to maintain a completed checklist to meet their due diligence requirements.

4.3. Expanding Working Group Efforts to ARRA & Tax Return Preparer Review

The Working Group will expand their current scope beyond EITC to serve the tax preparer community in response to two new servicewide initiatives:

- The American Recovery and Reinvestment Tax Act (ARRA) of 2009 expands existing tax credits and provides several new refundable tax credits. As part of this economic recovery legislation, Congress expanded the Earned income Tax Credit.
- The Service is launching the Tax Return Preparer Review to strengthen the integrity of the tax system through return preparer efforts. The goals are to increase taxpayer compliance by leveraging the tax return preparer community and to ensure uniform and high ethical standards for tax preparers through service and outreach, education and training, and enforcement.